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H I G H L I G H T S

The Soviet return to the UN, whatever its final outcome, will tend to obscure and confuse the efforts of the Western world to focus its energies exclusively on achieving a clear-cut settlement of the Korean situation. The present Soviet tactic of avoiding the Korean issue and attacking the US on the Chinese Communist and Taiwan questions does not preclude later Soviet efforts to seek a negotiated settlement in Korea while the military situation still favors North Korea (see page 2). In fact, by returning to the UN, the Kremlin revealed its belief that some such offer might eventually be necessary in order to counter the effect the Korean war has had in stimulating Western military preparations and to protect the Soviet position in North Korea.

As the Korean issue was being debated in the UN, it became clear that the feeling of urgency engendered by the Korean war was not in itself sufficient to overcome the many obstacles to building an effective Western defensive force (see page 4). Elimination of the numerous political, economic, and psychological factors retarding Western European rearmament programs still depends largely upon US ability not only to provide generous and speedy assistance but to convince Europeans of its willingness and ability to defend the European continent.

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SOVIET RETURN TO THE UN

By returning to the UN, the USSR is seeking to re-establish maximum diplomatic and propaganda maneuverability and perhaps to lay the groundwork for a negotiated settlement in Korea if the turn of events there convinces the Kremlin of the need for such a settlement. The Soviet Union may also hope to gain support in Asia by attacking the highly vulnerable US position on Taiwan.

The Soviet boycott was proving more and more disadvantageous to the USSR. Purely aside from failing to accomplish its avowed purpose--seating the Chinese Communist representative--the boycott denied the USSR the use of the UN either as a medium through which it could obstruct world action in support of South Korea or as a sounding board for Soviet propaganda. Moreover, the Kremlin probably reasoned that by boycotting the UN it was contributing both to the potentialities of the UN to marshal non-Communist world opinion and to the growing determination of the Western world to mobilize against Soviet aggression.

The vitriolic and obstructionist attitude of the USSR in the first three days following its return to the SC does not preclude a later Soviet effort to negotiate a settlement in Korea. By initially concentrating on the Chinese representation issue and procedural maneuvers, the USSR is attempting to confuse the questions of Korea and China as well as to save face by demonstrating that it has not abandoned the issue which precipitated the boycott and is therefore not returning to the UN out of weakness. Moreover, the USSR is under no immediate compulsion to seek a settlement of the Korean issue while UN forces are still suffering reverses in Korea. For the present, therefore, the Kremlin can be

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expected to make every effort to prevent the UN from focussing its attention exclusively on North Korean aggression. In such an effort, the USSR will concentrate its attacks where it considers the US to be most vulnerable--namely, the question of Chinese representation in the UN and the US stand regarding Formosa.

In the longer run, however, the USSR probably believes that it must offer some form of negotiated settlement in Korea if it is to counter the effect the Korean war has had in stimulating Western military preparations and to protect its position in North Korea. While North Korean successes continue, any Soviet peace offer would probably not go beyond proposals for the withdrawal of UN military forces and the holding of all-Korean elections possibly with some nominal international supervision. The USSR would exploit some such formula to portray the Soviet Union as a disinterested party concerned only with the restoration and maintenance of peace. It would also be designed to capitalize on North Korean victories by attempting a negotiated settlement on favorable terms before an eventual UN counter-offensive might carry across the 38th Parallel and culminate in the unification of Korea under UN auspices. Even if mediation on terms acceptable to the USSR is not feasible, the Soviet Union can seek to achieve more limited objectives by attempting to shift the blame for continued hostilities to the US and to block any UN-approved move to cross the 38th Parallel.

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EUROPEAN COLLECTIVE EFFORT

Over-all Defense As the North Atlantic Council deputies meet in London to expedite European defense efforts, it is clear that the nations of Western Europe, though more urgently aware of the need for an accelerated rearmament program, are in general not as yet prepared to make the substantial contribution required for building an effective defensive force. A variety of political, economic, and psychological factors are retarding European efforts in this direction. Although the Korean fighting has increased the general sense of urgency, the Europeans, unlike the US, are not so deeply involved in these military operations and therefore lack the same incentive for sacrifice. Most of the nations greatly fear the effect rearmament would have on their still precarious economic stability and see great difficulty in financing adequate rearmament programs. There is a general trend, led by France and Italy, toward attempting to shift the financial burden to the US through the creation of a "joint" fund with contributions based on national income. Moreover, continental Europe still lacks conviction that any effort it might exert would be sufficient to prevent Soviet occupation of all Europe. The US military reverses in Korea have also called into question the adequacy of US support in case of war. Nothing short of widespread assurance that the US will provide generous and speedy assistance, tangible evidence of a stronger US defensive posture, and the strongest US pressure will overcome European reluctance to make the necessary economic or political sacrifices, particularly those involving genuine relinquishment of national prerogatives necessary for the creation of a truly balanced collective force.

British Attitude The British have responded to the US appeal for an accelerated defense effort by announcing an emergency defense spending program of 100 million pounds, thus raising the 1950 defense budget by nearly 14 percent.

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In view of improved economic conditions, it is estimated that this increase will not create really serious new economic problems. Any further increase, however, would confront the Labor Government with serious political and economic problems. The government has consistently given economic recovery and welfare programs priority over defense, and any abrupt change in this policy with elections probably less than a year away would have obvious political repercussions. Moreover, Britain's planned economy has been strained almost to the limit in striving for economic recovery, with the result that there is little elasticity which would permit an immediate increase in allocations for defense. Over-all British military planning was originally based on achieving peacetime preparedness by 1956-7 and later rescheduled to 1954-6. The Labor Government can be expected to make strenuous efforts to speed up these goals, but it will require time and popular support.

French Views During the past six months the French have gradually been taking the lead in pushing for a unified Europe politically, economically, and militarily. More and more French leaders reason that Europe cannot effectively defend itself unless individual nations are willing to pool their resources and contribute to a truly joint military effort. Despite this evidence of French leadership, the immediate French response to the request for a greater defensive effort is limited to plans for a 20 percent increase in the 1951 military budget. Numerous political and economic considerations prevent a more substantial effort at this time. The French budgetary situation still sharply restricts the government's freedom to expand military expenditures. The measures necessary to divert economic effort from recovery to rearmament would be opposed by the Socialists as well as by the Right. Always critical of military expenditures, particularly in connection with Indochina, the Socialists would

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oppose any moves which would stand in the way of their demands for higher real wages or greater security for the civil servants. Rightist opposition to increased expenditures stems primarily from the fear that they would lead to the imposition of economic controls. Moreover, any diversion of ECA aid to military purposes would strengthen Communist propaganda claims that the European recovery program was designed to prepare for war rather than to improve the standard of living.

Italian Defense The Italian Government is reacting with vigor and determination to the call for an accelerated defense effort. The Italian Army will probably be increased as quickly as possible to full Treaty strength of 250,000 men, but even this limited force will lack effectiveness unless supplied with substantial quantities of modern arms and equipment. Italy's greatest potential contribution to the defense of Europe is its considerable reservoir of unused labor and industrial facilities capable of producing military equipment. Italy has nearly 2 million unemployed, many of them skilled or semi-skilled workers; numerous munitions plants are idle; and the ship-building, textile and other industries could be expanded without drawing dangerously on the present civilian economy. Italy by itself, however, would be incapable of supplying the funds necessary for converting these facilities to war production. Dollar assistance under the AMP program would be needed in order to obtain raw materials and to renovate and retool existing facilities. Any diversion of presently allocated ECA funds for that purpose, however, would not strengthen the over-all Italian economy or exploit Italy's unused resources. Moreover, as in France, such a diversion of US aid would add plausibility to the current Communist "peace" propaganda campaign.

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West Germany Although the Korean conflict has heightened West Germany's fear of Soviet aggression and caused misgivings with regard to its relations with the West, the overwhelming weight of West German press and public opinion appears to condemn the USSR and North Korea and to approve the firm policy of the UN and the US. Despite growing fears that German lives will be sacrificed in the event of war, however, West Germans wish to take no direct action regarding the question of their own defense. The Federal Republic, therefore, strongly favors the establishment of a federated European state to which West Germany will be admitted on an equal basis. Germans feel that a general surrender of sovereign rights by the nations of Europe would improve Germany's relative position because the Federal Republic has little sovereign power to lose. Moreover, they reason that West Germany's best protection against aggression is participation in a European federation charged with over-all responsibility for the defense of Europe. Coincident with the growing interest in full European federation, West Germans are also expecting as the price of continued support of the West a formal guarantee by the Western Powers of the territory of the Federal Republic, drastic revision of the Occupation Statute, termination of the restrictions on German industrial production, and continuation of US economic aid after 1952.

Swiss Reaction Swiss apprehension concerning the ability of Western Europe to defend itself has grown since fighting began in Korea and will manifest itself in demands for greater Western rearmament and a marked strengthening of Switzerland's own "armed neutrality." Firmly believing that armed strength is the best guarantee of peace, the Swiss will probably urge a strengthening of US occupation forces in Germany, a re-establishment of West

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German military force, and greater Western European preparedness. At the same time, the Swiss are planning to build up their own military power and are expected shortly to add more than one billion francs to their military budget for equipment for the Swiss Army.

Scandinavian Reaction Scandinavian reaction to UN reverses in Korea has been mixed, with alarmist tendencies being voiced more extensively in Sweden than in Denmark and Norway, which still feel that the North Atlantic Pact offers them their best hope of security. If the US embarks on an extensive program of rearmament, Danes and Norwegians will be reassured that the defense system of the NATO will not be neglected and may, in fact, be stronger than before the Korean war. Furthermore, they are likely to feel impelled to make a greater contribution to their own defenses and not rely almost solely on the US.

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ECONOMIC TRENDS

Yugoslav Difficulties The ability of the Tito Government to maintain its independence in the face of growing Cominform pressure and to foster the spread of "nationalist" Communism may be undermined by a deteriorating economic situation, and particularly by the continued low standard of living for the Yugoslav people. Since the break with the Cominform, Yugoslavia has committed itself to an ambitious program of industrial development which has caused serious foreign exchange shortages with a consequent curtailment of expenditures for the production of consumer goods. In addition, Yugoslavia has been forced to devote a greater share of its own resources to strengthening its armed forces, thereby causing a further drain on its meager foreign exchange reserves. With investment priorities going to heavy industry and military production, Yugoslavia has been unable to meet its consumer production goals and as a result will probably have greater difficulty in collecting from the peasants the foodstuffs required both for feeding the urban population and for meeting its export commitments. Any further decline in the Yugoslav standard of living would weaken home morale at a time when the government needs to increase popular support and would appear to substantiate Soviet propaganda claims that Yugoslavia is being exploited by the West and cannot build a Socialist state without Soviet assistance.

East-West Trade Eastern Europe's continued need for trade with the West in order to obtain foreign exchange and vital products is illustrated by Czechoslovakia's improved foreign trade position with the West in the first half of 1950 and a reported arrangement whereby a Swedish firm would serve as an intermediary for transactions between Eastern Europe and Spain. Although total

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Czechoslovak trade with the West has not increased, Czechoslovakia has been able for the first six months of 1950 to show a favorable export balance with several countries, including the US, and has instituted or reactivated trade agreements, in some cases requiring Czechoslovak concessions, with such countries as Brazil, Israel, and France. Czechoslovak interest in promoting this trade probably stems largely from the realization that without it the country would be unable to purchase materials required to produce items it is committed to export to the Soviet orbit. Meanwhile, contract authorization for trade between Spain and Eastern Europe has been reported in the amount of \$17.5 million each way with Spain delivering principally wolfram and pyrites in exchange for coal. Although Spain will probably be unable to fulfill its obligations to such an extent, the exchange of these commodities is logical, avoids the use of hard currency, and may be welcomed by Franco as a lever to extract aid from the US.

Japanese Economy The immediate effect of the Korean war on the Japanese economy will probably be to increase inflationary pressures by stepping up both employment and the demand for industrial goods. Emergency US purchases for military and ECA requirements for Korea will increase Japan's production and employment and improve its dollar position and more than compensate for the insignificant effects of the loss of Korean trade. The resulting inflationary pressures may force a restoration of some of the economic controls which SCAP has been gradually relaxing over the past two years. On the other hand, as a result of stepped-up business activity, the Japanese will increase their demands for a relaxation of credit control features of the Dodge deflationary program. Greater expenditures for the new police reserve have already forced the Japanese Government to modify the debt retirement features of the Dodge-inspired balanced budget and increased pressures for higher government wages may force further concessions.

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Korean "Integration" North Korean propaganda claims that economic and political reforms are being implemented in "liberated" areas may be preliminary to an early formal announcement by the Communists that "liberated" southern Korea has been completely integrated into the framework of the Democratic Peoples Republic. Although the prolonged fighting has disrupted the pre-hostilities timetable of the Communist "unification front" which called for the establishment of a unified national government in Seoul on 15 August following national elections during the period 5-8 August, the North Koreans now claim that elections have been held for local "People's Committees" in all the "liberated" provinces. Furthermore, the North Koreans have announced that "land reform" will be implemented throughout the "liberated" areas immediately, that North Korean currency has been made the only official medium of exchange in the south, and that the "democratic" tax system of the north is now in effect in southern Korea. Preparations are thus nearly complete for an announcement, possibly on 15 August, that the people of southern Korea are unanimous in their support of the Democratic Peoples Republic, that basic reforms have been completed, and that the liberated areas have been formally integrated into the "Peoples Republic."

Chinese Security The Chinese Communist regime has become seriously concerned over the increase in dissident activities and is instituting a vigorous drive against "bandits" and "counter-revolutionaries." Preoccupation with internal security will tend to reduce the willingness of the Peiping regime to employ its armed forces in operations other than the "liberation" of Taiwan and the possible commission of further Korean forces from Manchuria to the Korean conflict. Following

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official statements referring to the presence of at least 400,000 "bandits," the Communist press is now devoting great space to accounts of the arrest of saboteurs and the breaking up of "counter-revolutionary rings" which are said to be destroying railroads, circulating counterfeit money, and assassinating public workers. The ranks of active dissidents have been swollen by dispossessed and disillusioned segments of the population, and all these groups may recently have been emboldened by the hope that a general Far Eastern war would dislodge the Communist regime. On 20 July, Communist Premier Chou En-lai, revealing that the regime's existing security apparatus is inadequate to suppress dissident activities, announced a decision to establish special "People's Tribunals" to "protect the revolutionary order." The Tribunals will be empowered to arrest, detain, and impose penalties ranging from public repentance to death, although the severer sentences must be approved by higher authority. Because Communist administrators on the lower echelons have generally been prone to abuse their power, it is possible that the vigorous drive being launched against dissidents will develop into a reign of terror.

Viet Minh Offensive Definite preparations are under way for a Viet Minh offensive against the French.

Large concentrations of Viet Minh troops are reported in positions from which strong separate or coordinated attacks could be made. The rainy season, now at its height, usually precludes large-scale military operations, but it is quite possible that Ho's forces will launch early attacks against the vulnerable French posts at Lao Kay and Cao Bang on the Chinese border. Although there is no evidence pointing to an early Chinese Communist invasion of Indochina, rebel forces have received substantial supplies from China, and 10,000 Vietnamese reportedly are undergoing training under Chinese instructors across the Indochinese border, where they are immune from French attack or aerial reconnaissance.

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and can threaten French border positions. Meanwhile, the French are continuing to emphasize the need for a military solution in Indochina, minimizing political measures on the theory that Vietnamese political allegiance will be to the stronger side. The French are thus underestimating both Communist ability to win popular support in the Far East and the importance of giving the general population a stake in the Bao Dai regime.

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LOCAL DEVELOPMENTS

SPAIN

Proposed US Loan The proposal to lend Spain \$100 million, without the restrictions imposed on present recipients of ECA aid, will have generally unfavorable repercussions throughout Western Europe. It will encourage defeatism by leading officials and the public to believe that the US has decided it cannot defend Western Europe against Soviet aggression and is attempting to strengthen Spain in order to provide a bridgehead behind the Pyrenees for the eventual liberation of the continent after it has been overrun. It will provide Communist propagandists with what many Europeans will consider to be at least prima facie evidence of the truth of Communist charges that the US supports fascism. Finally, it will offend the recipients of ECA aid who feel that they have had to give up some of their sovereignty by complying with ECA controls in order to receive ECA aid. They will thus resent the preferential treatment accorded to Spain, which is not a member of the Atlantic Pact, which has been diplomatically isolated by action of the UN, and which has never been an ally of the US.

BELGIUM

Leopold Solution King Leopold's delegation of his powers to Prince Baudouin after only ten days on the throne eases the immediate crisis in Belgium, but the political strife and personal animosities engendered by the struggle over the King will hinder the effective implementation of domestic and, to a lesser extent, foreign policies for some time. The fact that the Social Christian leadership was a party to the

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agreement with the Socialists and Liberals, and that the Social Christian Party will continue its dominant role, whether in a one-party Cabinet or in a coalition with the Liberals, will prevent any serious civil disturbances resulting from Flemish (Catholic) dissatisfaction with the solution. Although the political breach would be healed more rapidly if the Socialists were included in the government, even for a short time, this is unlikely at present.

LATIN AMERICA

Aid to Korea Latin American responses to the UN request for assistance in Korea have clearly indicated that little military assistance can be expected in the immediate future. Bolivia and Costa Rica have made specific offers of military aid (thirty officers from Bolivia and volunteers and naval and air bases from Costa Rica). Also it is quite possible that other offers may be made when these countries receive more definite indications regarding the kind and number of forces needed, as well as some assurance that their offers will not be rejected.

Latin American countries have been reluctant to make military commitments at this time, in part because of domestic considerations, such as isolationism in Argentina and elections in Brazil. Also, most Latin American nations are quite aware of their inability to furnish more than token contributions. In many countries the principal support for direct military aid is within military circles, and interest among other segments of the population is not strong enough to provide a political basis

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for direct aid. Points of difference between the US and various Latin American governments (particularly Brazil) and the feeling that the US has subordinated Latin American interests to those of Europe in the post-World War II period have cooled some of the enthusiasm for US leadership which existed in 1945. Finally, Latin American nations do not regard the present situation as an immediate threat to their security nor do they feel any incentive to advance their own interests by immediate action.

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